IN THE

Supreme Court of the United States

OCTOBER TERM, 1944.

No.....

THE PENFIELD COMPANY OF CALIFORNIA,

Petitioners,

vs.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

BRIEF IN SUPPORT OF THE PETITION FOR WRIT OF CERTIORARI.

I.

The Securities and Exchange Act, Section 19(b), provides as follows:

> "(b) For the purpose of all investigations which *in the opinion of the Commission*, are necessary and proper for the enforcement of this title, any member of the Commission or any officer or officers designated by it are empowered to administer oaths and affirmations, subpena witnesses, take evidence, and *require the production of any books, papers, or other documents* WHICH THE COMMISSION DEEMS RELEVANT OR MATERIAL TO THE INQUIRY. Such attendance of witnesses and the production of such documentary evi-

dence may be required from any place in the United States or any Territory at any designated place of hearing." (Italics and caps ours.)

Section 19(b) of the Act empowers the Securities and Exchange Commission to invade the privacy of citizens and corporations by making of investigations which, in the opinion of the Commission, are necessary and proper for the enforcement of the Act. This section definitely gives the authority to issue subpoenas *duces tecum* after the Commission has made a finding that in its opinion the books, papers, documents and records are deemed by the Commission to be relevant or material to its inquiry.

It is admitted of course that the Commission made no such finding and that the attempt to issue a subpoena *duces tecum* was made by someone not even a member of the Commission.

The subpoena power is considered very drastic and no power to issue subpoenas exists except in accordance with the constitutional mandates.

Cudahy Packing Co. v. Holland, 315 U. S. 357, 86 L. Ed. 895;

Lowell Sun Co. v. Fleming, 120 Fed. (2d) 213, 86 L. Ed. 1191.

It will be noted that in order to secure a subpoena *duces tecum* from court such application for the subpoena must describe in the subpoena the papers, writings, books or other documents supposed to be in the possession or power of such witness, and it must be presented to a judge, who must be satisfied by the affidavit of the person applying, or otherwise, that there is reason to believe such papers,

writings, books or other documents are in the possession or power of the witness, and that the same, if produced, would be competent and material evidence for the party applying therefor.

It cannot be conceived that the Congress, in passing the Securities and Exchange Act, authorizing the issuance of a subpoena *duces tecum* in a proper case, intended that the subpoena *duces tecum* should be issued on any other conditions for the Commission than those provided for trial courts, and it did not give the Commission authority beyond or different than it gave to any person applying to a court for a subpoena *duces tecum*. Had it done any less than this it would have conflicted with the Fourth Amendment to the Constitution of the United States.

In *Grau v. United States*, 287 U. S. 124, 129, 77 L. Ed. 212, 214, the Supreme Court of the United States held that a warrant is void for failure to observe the statutory requirement that it state the particular grounds or probable cause for issuance, and for the further reason that it is based on affidavits which do not set forth the facts tending to establish the grounds of the application or probable cause for believing that they exist. The court held that the affidavits in that case were insufficient as they unduly narrowed the guaranties of the Fourth Amendment, in consonance with which the statute was passed. Those guaranties are thereby liberally construed to prevent impairment of the protection extended. (*Boyd v. United States*, 116 U. S. 616, 635, 29 L. Ed. 746, 751; *Gouled v. United States*, 255 U. S. 298, 65 L. Ed. 647, 650; *Go-Bart Imp. Co. v. United States*, 282 U. S. 344, 357, 75 L. Ed. 374, 382.)

As stated in the *Grau* case further, "Congress intended, in adopting Section 25 of Title 2 of the National Prohibition Act, to preserve, not to encroach upon, the citizen's right to be immune from unreasonable searches and seizures, and we should so construe the legislation as to effect that purpose."

Tested by the provisions of the Constitution and the statute before a valid subpoena *duces tecum* could be issued by the Securities and Exchange Commission it was necessary to be presented by the Commission a list of the things supposed to be in the possession or power of such witness, and thereupon it was necessary for the Commission to make a finding that, in its opinion, these books and papers were necessary for the proper enforcement of the title, and that the Commission deemed these articles relative or material to the inquiry.

No such request was made, apparently, of the Commission, and no finding was made by the Commission that it deemed these books and records necessary and proper for the enforcement of this title. [R. 2, 8, 12.]

At this point, for the sake of argument, if Congress could constitutionally delegate this judicial function to the Securities and Exchange Commission—to find what was necessary and proper for the enforcement of this title, then the Commission would have to have presented to it, in order to comport with the Fourth Amendment, an affidavit setting forth the articles sought and the reasons for seeking them. The documents and things sought would have to be described with particularity

The statutory provision either must be as broad as the constitutional guaranty which it seeks to avoid, or else

the statute itself is unconstitutional. The situation is comparable to that in *Counselman v. Hitchcock*, 142 U. S. 547, 35 L. Ed. 1110, wherein the immunity provisions of the Fifth Amendment were sought to be met by provisions granting to those who testified immunity from prosecution. Because the statute was not as broad as the constitutional guaranty, the Supreme Court held the statute unconstitutional.

II.

The attempted delegation of authority to the investigator of the Securities and Exchange Commission to subpoena at his whim any books and records would constitute a roving commission. It would indeed be delegation running riot. Congress never intended such a wide authority and did not grant it. It would enable any investigator to do that which only the Commission itself has a right to decide might be done.

As to delegation running riot, the investigator would be in the same position as those condemned in the earlier decisions of England and America. (See *Boyd v. United States*, 116 U. S. 616.)

III.

The attempt to delegate the absolute power to make a finding as to what should be subpoenaed is itself a violation of Article III of the Constitution of the United States granting judicial powers only to the judiciary. The Fourth Amendment to the Constitution forbids against unreasonable searches and seizures. The judiciary is given the power to pass on whether the search is or is not unreasonable. Can Congress confer this power upon the Securities

and Exchange Commission and require that the Commission itself make an absolute finding as to whether its investigation, the books, papers and records which it is seeking to investigate, are relevant and material to its inquiry which would be absolutely binding on the courts? We contend that this is a judicial function and that in so far as the statute attempts to give this power to the Securities and Exchange Commission it is unconstitutional as a violation of Article III of the Constitution of the United States.

IV.

The Contract Was Not Within the Jurisdiction of the S. E. C.

The bottling contract in this case was as follows:

"Federal Alcohol Administration Wholesaler's Basic Permit No. PD-12377

The Penfield Company of California

Distillery Factors and Controllers

Spring Arcade Building

Los Angeles, California

No..... Dated.....

Name..... Address

Hereinafter called the seller and The Penfield Company of California, hereinafter called the buyer, contract and agree between themselves unto the following:

1. In consideration of the execution of the within sales agreement, the seller hereby sells and assigns to the buyer, the following described whiskey:

.....

Distillery Barrels Serial Nos. When Made Tax Due

.....

Now Insured With.....

Storage or Other Charges Paid to.....

Title to said whiskey to pass to the buyer from the seller upon delivery of warehouse receipts, as described above, and the execution of this agreement.

2. The buyer intends to cause the said whiskey to be bottled after the same has reached four years of age or over, and intends to offer or cause to be offered such bottled goods for sale. After said whiskey has been bottled and sold, the buyer shall pay to the seller such an amount which the buyer received from the sale of said bottled goods, less all insurance, storage, taxes, costs, expenses advanced or incurred by the buyer, transportation, bottling, stamping, labeling, and ten per cent of the gross per case sales price. The buyer shall furnish to the seller figures compiled from government records showing the actual amount of whiskey in barrels and number of vases it produced, together with prices received. The buyer reserves the right to bottle and pay for any portion of said whiskey from time to time as contemplated herein.

3. The seller vouches himself to be the true and lawful owner of the within warehouse receipts with full right and authority to dispose of the same in the manner aforesaid, and further agrees that the buyer may do any and all things which in the buyers opinion are incident to the interests herein, and the seller further agrees to warrant and defend the said warehouse

receipts to the said buyer against all claims and demands.

4. This contract contains the entire agreement of the parties hereto, and the seller agrees that no representations were made other than those herein set forth.

5. This contract executed in duplicate, is subject to acceptance by the buyer at its office. An exact copy of this agreement is hereby acknowledged which is an interim receipt for the above whiskey, pending receipt of the executed original agreement.

Witness..... .....Seller
(Seal)

Accepted

THE PENFIELD COMPANY OF CALIFORNIA

By .....
President-Treasurer Buyer

(The distilled spirits herein will be packaged before sale in bottles labeled and marked in accordance with law and the rules and regulations of the Federal Alcohol Administration.)"

This contract did not constitute an investment contract.

In its generic sense of the word every contract is an "investment contract" but in these proceedings contracts which merely deal with the recipients making a profit from the bottling of whiskey is not the type of contract which gives the Securities and Exchange Commission jurisdiction.

People v. Davenport, 21 Cal. App. (2d) 252

A security does not extend to ordinary commercial contracts, nor does it include interest income from the lending of money or the profits which one might make from his own efforts as the result of any ordinary commercial contract. (*Lewis v. Creasey Corp.*, 198 Ky. 407, 248 S. W. 1046.)

V.

The District Court Erred Therefore in Holding That Bottling Contracts of The Penfield Company of California Were Transactions in Securities as Defined in Section 2(1) of the Securities Act of 1933 and Therefore Conferred Jurisdiction Upon the Securities and Exchange Commission.

These contracts were contracts to bottle whiskey and pay the tax on it. They were not contracts for a security, but for the performance of certain work and labor in connection with the bottling of whiskey. Many wholesalers, retailers, large corporations, hotels, etc., daily send warehouse receipts owned by them to licensed bottlers with instructions to the bottlers to "tax pay" the whiskey, bottle and label it and ship it to them through the regular channels of bottler to a licensed wholesaler, wholesaler to licensed retailer, retailer to the original owner, etc., as the case may require. The bottler bills the wholesaler for the taxes and other charges he has paid, plus his cost of bottling. The wholesaler bills the retailer for the same charges, plus his handling fee, and the retailer does likewise.

There is nothing in the transaction, therefore, that makes it a security within the meaning of the Securities Act.

VI.

The District Court Erred in Holding That Transactions in Distillers' Whiskey Warehouse Receipts and Matters Relating to Alcohol Were Transactions Within the Meaning of Section 2(1) of the Securities Act as Amended in 1933.

A warehouse receipt represents the property described therein, and a transfer of the same is a symbolic delivery of the goods called for by the receipt and passes title to the goods as effectually as if an actual delivery were made. (Civ. Code, sec. 1858b; *A. Widemann Co. v. Digges,* 21 Cal. App. 342, 131 Pac. 882; *Cavallaro v. Texas etc. Ry. Co.,* 110 Cal. 348, 42 Pac. 918, 52 Am. St. Rep. 94; *Garoutte v. Williamson,* 108 Cal. 135, 41 Pac. 35; *Bishop v. Fulkerth,* 68 Cal. 607, 10 Pac. 122; *Davis v. Russell,* 52 Cal. 611, 28 Am. Rep. 647.) Thus, by the issuance or transfer of a warehouse receipt for whiskey held in bond in Kentucky, there is in fact a sale and a constructive delivery within the state of California of a commodity, although at the time of the sale it is and may forever remain elsewhere, and as between the vendor and the vendee there is no distinction between the solicitation of orders for the whiskey and the solicitation of orders for warehouse receipts representing the same.

VII.

The District Court Erred in Holding That Each of the Twenty Items Was Within the Scope and Jurisdiction of the Securities Act Giving the Commission Power to Investigate Them.

The District Court erred in holding that each of the twenty items which the subpoena, issued by an employee of the Securities and Exchange Commission, sought to get, was within the scope and jurisdiction of the Securities Act, giving the Commission power to investigate them.

It was error for the District Court to grant the application of the Commission and to issue its order requiring appellant to produce for examination by the Commission or its representatives "All books, records, documents, contracts, agreements, checks, bank statement, correspondence files and all other papers and memoranda in which have been entered a record of the transactions and business of The Penfield Company of California *from the date of its incorporation to the date of this subpoena*, including in particular, the following:" followed by items numbered 1 to 20, inclusive, of said Order.

The record shows that many of these things were not within the scope or sphere of the Securities and Exchange Act. The taking of them constituted an unreasonable search and seizure. (*Jones v. Securities and Exchange Commission*, 298 U. S. 1, 80 L. Ed. 1015; *Hale v. Henkel*, 201 U. S. 43, 55 L. Ed. 873; *Federal Trade Commission v. American Tobacco Co.*, 264 U. S. 298; *Boyd v. United States*, 116 U. S. 616, 29 L. Ed. 746; *Interstate Com. Commission v. Brimson*, 154 U. S. 447.)

The measure of power is the mode prescribed in the statute.

Stark v. Wickard, 88 L. Ed. 511, 522;
Head v. Providence Insurance Co., 2 Cranch. 156;
Zottman v. S. F., 20 Cal. 102;
Michelson v. Painter, 35 Cal. 705;
People v. Gunn, 85 Cal. 238, 248.

In *Annenberg v. Roberts,* 333 Pa. 214, decided by the Supreme Court of that state (1938), the court after quoting the above excerpt from the opinion of Chief Justice Rugg of the Massachusetts Supreme Court added (p. 214):

> "While the act under consideration in the present case seems to recognize this fundamental principle, since it authorizes the issue only of such subpoenas as require answers to questions *'touching matters properly being inquired into by the Commission'* and the compulsory production only of such books, papers, records and documents as relate *'to the subject of inquiry,'* we are in accord with the observations made by the court below as to the irrelevance of information called for in the subpoenas issued to these plaintiffs; it follows that there is a constitutional lack of power in the Commission to demand it." (Italics supplied.)
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> "The subpoenas show on their face that they contemplate an unreasonable search and seizure. They violate the principle which we announced in *American Car & Foundry Co. v. Alexandria Water Co.,* 221 Pa. 529, where we held that a subpoena *duces tecum* could not properly be issued to bring in a mass of books and papers in order that there might be a search through them to gather evidence. We, therefore, are of opinion that the subpoenas as issued

commanding plaintiffs to produce before the Commission the things therein set forth are void, in that they do not show that the demands are germane to the inquiry authorized by the Governor's call. . . ."

VIII.

The District Court Erred in Holding That the Provisions of Section 19(b) of the Securities Act of 1933 as Amended and Supplemented by the Provisions of Section 22(b) of Said Act, Inherently and as Construed and Applied in This Case, Are Not Invalid and Unconstitutional Because They Delegate Judicial Powers to the Securities and Exchange Commission in Violation of Article III of the Constitution of the United States, and Deprive the District Court of Judicial Functions as to What Matters Are or Are Not Relevant or Material to the Inquiry.

Pacific Railway Commission v. Stanford, 32 Fed. Rep. 241, approved in *Interstate Commerce Com. v. Brimson,* 154 U. S. 447, and *Innes v. Securities and Exchange Commission,* 80 L. Ed. 1015.

The power of the S. E. C. to make findings as to whether books, papers, or documents are material to the inquiry, binding upon the courts is here challenged, since that body does not have judicial powers. The act therefore unconstitutionally delegates these powers to the Commission.

For all of which reasons petitioners pray that a writ of certiorari be granted and that the judgment and order below be reversed.

Respectfully submitted,

MORRIS LAVINE,
Attorney for Appellant.

State of California, County of Los Angeles—ss.

Morris Lavine, being first duly sworn, upon his oath deposes and says that he is one of the counsel for the appellants, The Penfield Company of California, Appellant; that he has read the foregoing Petition for Writ of Certiorari to the Ninth Circuit Court of Appeals of the United States and Brief in Support Thereof, and knows well the contents thereof; that he has carefully read and studied the transcript of record and proceedings in the case at bar; that the matters in said petition are in the judgment of this affiant duly supported in and by said transcript of record and proceedings, and that he verily believes the facts stated in said petition are true.

MORRIS LAVINE.

Subscribed and sworn to before me this 14th day of September, 1944.

ZOA L. ZACCHE,

Notary Public in and for said County and State.